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C O N F I D E N T I A L SECTION 01 OF 03 ANKARA 003017

SIPDIS

STATE FOR E, P AND EUR/SE
TREASURY FOR OASIA - MILLS AND LEICHTER
STATE FOR USTR - NOVELLI AND BIRDSEY
USDOC FOR 4212/ITA/MAC/OEURA/DEFALCO
NSC FOR QUANRUD AND BRYZA

E.O. 12958: DECL: 05/05/2005
TAGS: ECON PGOV EFIN MARR TU
SUBJECT: MILITARY PENSION FUND THRIVING IN TROUBLED ECONOMY

Classified by Econ Counselor Scot Marciel for reasons 1.5 (b)(d).

¶1. (C) Summary: Since Turkey's financial crisis in early 2001, OYAK, the Turkish military pension fund, has been one of the country's most profitable companies (it was the most profitable in 2001.) Its critics accuse OYAK of having unfair tax advantages, and see OYAK's prominence as the military's influence on the economy. This report examines OYAK's businesses (focused on auto manufacturing and banking), and finds its recent success owes more to its savvy management team under CEO Coskun Ulusoy than to any special GOT benefits. OYAK made a killing in the financial markets in 2001 because Ulusoy predicted the devaluation and switched from lira to dollar investments. He is currently making money the old-fashioned Turkish way (investing in T-bills). But OYAK is not just another private sector Turkish firm invested in T-bills - its initial source of liquidity is its 10 percent levy on military officers' salaries. OYAK's success is helping a privileged group -- Turkish military officers -- enjoy even more benefits. End Summary.

What is OYAK?

¶2. (U) Founded in 1961 to deal with the grievances of underpaid military officers following the 1960 military coup, OYAK (a Turkish acronym for the "Armed Forces Pension Fund") is a supplementary social security institution for more than 200,000 active duty officers (160,000) and retired pensioners (40,000). Its initial source of income is a compulsory 10 percent levy on the net salary of all military officers (additional premiums, paid on an optional basis, provide life insurance and disability benefits). Pensions are paid to all discharged members who have fulfilled at least 10 years of service with the military. Retirees then have the option of reinvesting a portion or the entire amount of their benefits back into the fund. In 2002, OYAK paid out to its members an average return of 41 percent (30 percent inflation) while in 2001 the average return was 95 percent (69 percent inflation), according to OYAK annual reports.

¶3. (U) In addition to portfolio investments in Turkish stocks and government securities, OYAK is an unusual pension fund that directly manages most of the 27 companies it invests in. Its companies span the sectors of financial services, automotive, cement, food and chemicals, and various services. Its subsidiaries' total asset value in 2002 was TL 5.9 quadrillion ($4 billion). Its annual profits in 2001 were TL 594 trillion ($486 million), a year-on-year increase of 173 percent; annual profits in 2002 were TL 495 trillion ($329 million).

¶4. (U) For most of OYAK's history, its top breadwinner has been its partnership with French automotive giant Renault. In 2001, this joint venture produced 170,000 vehicles and registered gross sales of $766 million, becoming Turkey's top auto producer. However, revenues have decreased heavily since the country's economic downturn the past two years. In the past three years, OYAK-Renault has gone from exporting 40 percent of its vehicles three years ago to exporting 90 percent of its vehicles in the first four months of 2003. Since 2001, most of OYAK's 27 companies have struggled (like most Turkish companies), and new investment has largely been halted. (Comment: The high rates of return on government T-bills act as a disincentive for holding groups like OYAK to invest in companies. End Comment.)

¶5. (C) As the company's new diamond in the rough, OYAK Bank is the sole OYAK subsidiary receiving substantial investment this year (mainly to build a more advanced information technology backbone between all branches). In August 2001,

OYAK purchased Sumerbank from the Banking Regulation and Supervision Board (BRSA); Sumerbank was itself the product of a merger of six smaller failed banks that had been taken over by the BRSA. According to a Moody's report of November 2002, OYAK was fortunate not to have had much retail lending prior to the 2001 financial crisis, and did not experience spread deficiency rates as large as those of other banks when the crisis hit. OYAK Bank expanded its retail lending only after the official acquisition of SumerBank in January 2002. With just $20 million to get SumerBank running again, OYAK over the past 16 months has gone from a mere 11 branches to 230, and has gone from a virtually unprofitable institution to a bank that today is worth $400-600 million and is still growing, according to Ergun Okur, OYAK executive vice president. It is currently the 8th largest bank in Turkey - OYAK plans to make it the fifth largest in the next few years.

Taking Advantage of the 2001 Financial Crisis

¶6. (SBU) While not nearly as big as Turkey's famed Koc and Sabanci holding companies, OYAK was more profitable than either of them in 2001, and was among the top five most profitable Turkish firms in 2002. This is due primarily to OYAK's savvy investment policy under CEO Coskun Ulusoy (and also partly to the liquidity advantage of the 10 percent levy on officers' salaries). Hired in 2000, Ulusoy immediately overhauled the management of OYAK's companies, canceling $120 million in planned investments, opting instead to invest in stocks and securities. (Note: Ulusoy has a PhD in economics from the University of Pittsburgh, and is a former banking executive at Citibank, KocBank, and later Ziraat Bank. He has the reputation of a bottom-line, American-style business manager. He resigned as CEO of Ziraat Bank rather than give concessional loans to political cronies. He was a protg of Turgut Ozal, and has close contacts with retired generals disillusioned with the present government. End Note.)

¶7. (C) According to Executive VP Okur, Ulusoy anticipated in early February 2001 that devaluation was near and, thus, wanted to maintain as much liquidity as possible. In OYAK's 2001 annual report, Ulusoy says that it was within Turkey's "extraordinary economic conditions" that OYAK weathered the storm and posted a net profit of nearly $500 million. What the report does not say is that Ulusoy got out of many of the firm's lira investments before the devaluation. In February 2001, OYAK immediately sold large portions of its Turkish lira for dollars, going from 5 percent dollar assets prior to the crisis to 45 percent following it. Okur dismisses allegations made by some newspapers at the time that OYAK was tipped off to the devaluation.

¶8. (C) OYAK has been thriving ever since, investing in government securities with interest rates that have consistently been at least twice as high as real interest rates over the past two years. With the exception of OYAK Bank, Ulusoy has continued to halt new investments in its companies, choosing instead to allow the company's portfolio managers to invest as much liquid capital as possible into government securities. Okur shuns accusations of OYAK having special advantages or insider information, though he admits that this bonanza cannot last forever. "We're earning lots of money on interest rates and we realize that someday the government will say 'sorry, we can't pay this anymore.' We all know the end of the movie. But when it ends, I don't know," he stated.

Does Military Influence Give OYAK Added Perks?
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¶9. (U) OYAK is governed by Law No. 205, enacted in March 1961, which dictates that a Board of Representatives, comprised of 75 retired military officers, oversee a General Assembly, comprised of 20 Army officers and 20 civil servants, which, in turn, oversees the Board of Directors, comprised of three active generals, two retired generals, two civilians, and CEO Ulusoy. The law requires three auditors to oversee the Board's monthly meetings - one elected by OYAK's General Assembly, one assigned by the Prime Ministry, and one assigned by the Banks Union of Turkey. Says Okur, this independent audit board is designed to prevent military brass from unduly influencing OYAK's bottom-line goal of making profits.
¶10. (U) OYAK's critics allege that it is a tool the military uses to consolidate its power, accusing it of having tax advantages vis-a-vis competitors and, more sinisterly, of using its influence to militarize the economy. For example, former Le Monde journalist and former French Ambassador to Turkey and Egypt Eric Rouleau has written in Foreign Affairs

magazine that OYAK is exempt from all taxes and duties. While it is true that military officers enjoy greater privileges than civil servants at the same level (higher pay, subsidized military stores, ability to obtain lower-interest housing loans), this criticism of OYAK is simply not true. All of OYAK's economic enterprises pay corporate taxes, and any tax advantages it does have are similar to those of other pension funds. Our contacts at the GOT Ministry of Finance and the EU mission in Ankara say they have never found OYAK to enjoy special advantages because of its military links.

¶11. (U) Critics such as Rouleau also allege that OYAK is closely linked to its "sister firm," the TSKGV (Foundation for the Strengthening of the Turkish Armed Forces), which raises money through donations and invests in companies exclusively devoted to arms production. Because TSKGV receives much of its income through charitable contributions, the TSKGV enjoys a number of tax benefits. These benefits, however, do not extend to OYAK. Okur claims that, though it is not stated in Law No. 205, OYAK's company policy has always been to avoid all arms contracts, citing anti-competition factors as the reason. He said that there have been instances in the past when the TSKGV has taken majority ownership of companies in which OYAK had a small share. Wanting to avoid the perception that it is involved in war profiteering, OYAK would immediately sell off its shares. This was the case, said Okur, when the TSKGV bought Aselsan Electronic Industries.
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